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3 leave EAIMC, start new firm

By Fred Williams

NORWALK, Conn. — The three top executives of Evaluation Associates Investment Management Co. resigned July 31 to form a competing investment firm in nearby Westport, offering investment vehicles to bank trust departments.

Jim Ryan, who had served since mid-1988 as president of EAIMC, the bank funds management arm of Evaluation Associates Inc., quit along with Mark Portnoy and Mark Tonnucci, both senior vice presidents. Mr. Ryan and Mr. Tonnucci each joined Evaluation Associates Inc. in 1983; Mr. Portnoy joined in 1984.

The three now are founders and principals of Trust Advisory Group, which will offer investment services similar to the EAIMC manager-of-managers pooled funds to bank trust departments, according to Mr. Ryan.

Officials at Evaluation Associates declined to discuss the resignations of the three senior executives, but announced Robert P. Watson had been appointed president of EAIMC. Mr. Watson is one of the founding partners of Evaluation Associates and had served as president of EAIMC until Mr. Ryan assumed the post. Since then, Mr. Watson has been in charge of special projects and developing new investment vehicles.

EAIMC has approximately $1.5 billion in assets under management in 11 mutual funds and one commingled fund, said Mr. Watson. He declined to discuss clients, but sources say EAIMC offers its pooled funds to 25 to 30 small and midsize regional bank trust departments.

One source at Evaluation Associates said the resignations came as a surprise. The investment process will not be affected, "but it will be felt more in the client services area," the source said.

A trust investment officer at one client bank — First National Bank and Trust Co., Tulsa — said the resignations caught bank officials off guard.

"We got a (facsimile) letter from them on July 31 announcing the new firm," said the trust officer, who asked not to be identified. "It left us momentarily not knowing anyone there to talk to. They were the only three we had ever met. But within 24 hours we had a new name." The officer added there were no plans to make any changes.

Mr. Ryan said the three officers believed the timing was right to branch out on their own after working together for several years.

"We had a conversation or two before deciding to do something as important as resign. We had spent five years building an investment management service in some form at EAI. It wasn't sudden, and we had given it considerable thought," said Mr. Ryan.

He said the Trust Advisory Group has not had time to acquire its first client — "We've only been in business for 24 hours" — and does not plan to solicit EAIMC clients. But, he said: "They know us and we know them." ■

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CORRECTIONS & CLARIFICATIONS

• **Quantum American Inc.**, New Orleans, was one of the fixed-income managers hired by the City of New Orleans Employees' Retirement System in its recent restructuring. The firm was identified incorrectly in the June 26 issue.

• A July 24 article reporting a decline of $1 billion in indexed fixed-income assets managed by **Dimensional Fund Advisors** was incorrect. Dimensional manages those assets in a semipassive portfolio.

• **James Lockhart**, the new executive director of the Pension Benefit Guaranty Corp., does not believe plant shutdown benefits belong in a pension plan. Also, he is relocating from Darien, Conn. An article in the July 24 issue

FIXED-INCOME INVESTING

Pension execs pass on gimmicks

Opt for proven strategies

By Trudy Ring

The maxim, "If it's not broken, don't fix it," describes the attitude of many pension fund executives toward their fixed-income investments.

Investment officers at several large funds said they're sticking with strategies that have proven successful, such as duration-matching, dedications or indexing, and aren't shopping around for the newest ideas in bond management.

These responses are borne out by research from Greenwich Associates, the Greenwich, Conn.-based consulting firm, which showed minimal interest in making changes in the fixed-income investment approaches.

According to the Greenwich Associates survey, 72% of corporate pension funds use active fixed-income management, and only an additional 4% plan to start.

Among public funds, 89% use active fixed-income management, and only an additional 1% plan to start.

The survey showed that 23% of corporate funds use immunized or dedicated bond portfolios and only 3% plan to use them, while 10% of public funds use these approaches and again, only 3% plan to use them.

Other passive bond approaches are used by 21% of corporate and public funds alike, and only 3% of each plan to begin using them.

High-yield bonds have limited appeal, with only 7% of corporate and 9% of public funds using them, and only 2% of corporate planning to begin using them. No public funds not now using junk bonds plan to begin using them.

Some funds using active strategies are buying short-maturity instruments, because of the currently flat yield curve, while not making major shifts in approaches.

Many of the duration-matched and dedicated portfolios were set up several years ago. Executives don't predict a major new wave of dedications because of the drop in interest rates. However, the interest in matching duration of assets and liabilities has increased.

Late last year, the $3 billion Public Employees' Retirement Fund of Indiana, Indianapolis, began putting its new cash flow into an index fund whose benchmark has a longer duration than most bond indexes and therefore is closer to the duration of liabilities (*Pensions & Investment Age*, Dec. 12).

To date, that cash flow has amounted to $250 million, said Lee Tanner, president of Prime Capital Management Inc., Indiana. Prime Capital manages $1.5 billion in bonds for the public employees' fund, its sole client.

The index is the Salomon Brothers Core Plus 5 Index, which is the Salomon Brothers Broad Investment Grade Bond Index minus treasury and agency se-

Continued on page 14

Demand for fixed-income products

	Active bonds		Passive bonds		Immunized/ dedicated		High yield	
	% now using	% planning to use	% now using	% planning to use	% now using	% planning to use	% now using	% planning to use
Corporate	72	4	21	3	23	3	7	2
Public	89	1	21	3	10	3	9	0
Union	86	2	35	6	22	6	4	0
Endowments/ foundations	90	1	12	3	4	3	15	2

Source: Greenwich Associates Inc.

New tack in foreign accounts

By Margaret Price

The rise of the dollar in the past 18 months has turned the interest of pension funds considering foreign bond investments to a global rather than an international approach.

This is the reverse of their approach to international equities, where the funds generally have wanted their managers to be international, not global managers: they wanted them to stay out of the United States, where they have specialized U.S. managers.

Given the popularity of international equities during the 1980s, at least some investors and analysts initially expected international bonds also to catch fire with pension funds.

That thinking, however, was at least premature. The dollar's volatility and the hot debate over whether foreign bonds should be a separate asset category have slowed any action.

Those who have committed to foreign bonds recently have been seeing global bond managers as the answer to such potential problems as currency hedging and drops in foreign bond prices. A global strategy allows the manager to move into dollar-denominated bonds when appropriate.

In addition, there is minimal interest among pension executives for passive foreign fixed-income strategies.

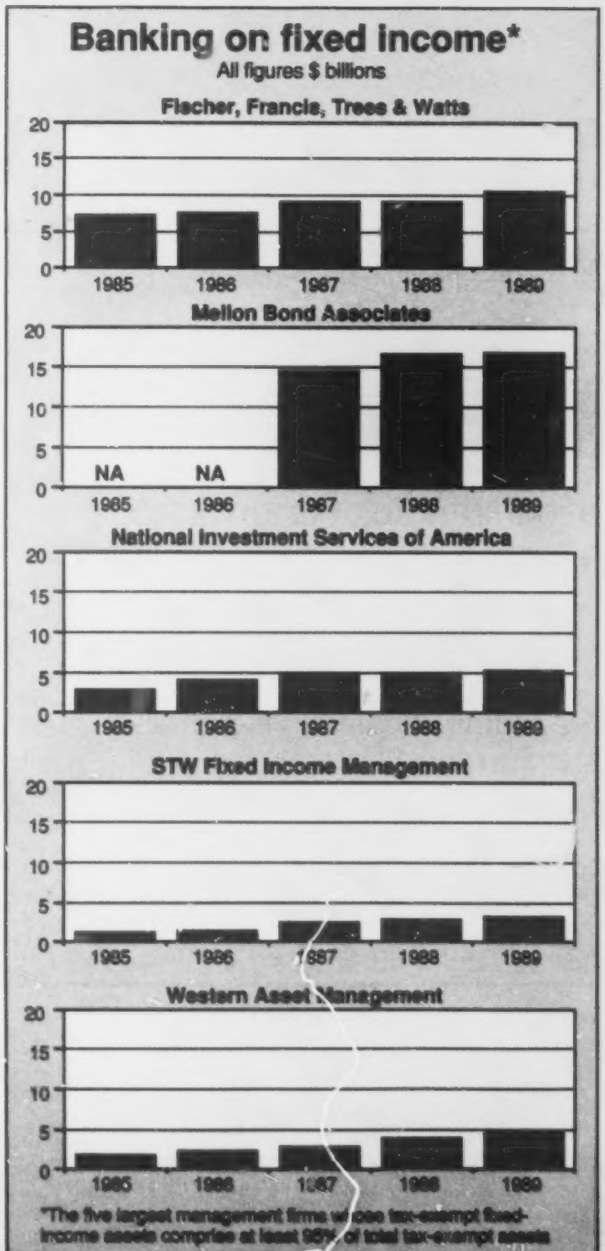
Global bonds haven't surpassed international fixed in come in terms of overall popularity. Data from InterSec Research Corp., Stamford, Conn., show that in 1988, total foreign bond investments by pension funds reached about $9 billion. Of that, about 40% was in global mandates, 60% in international.

But because of bonds' characteristics, such as their close linkage with currencies and sometimes other countries' interest rates, some consultants, money

Continued on page 16

Banking on fixed income*

All figures $ billions



*The five largest management firms whose tax-exempt fixed-income assets comprise at least 95% of total tax-exempt assets

Structure gains

But firms don't forgo active styles

By Leonard J. Hollie

A more structured bond account may be gaining in popularity among some plan sponsors, but managers are not ready to write off active fixed-income management strategies just yet.

"We are seeing that more people want a passive strategy," said Gary Coburn, senior managing director in charge of fixed income for The Putnam Cos., Inc. "Plan sponsors are focusing less on active approaches. Active approaches are not as active as they were 10 years ago, but I don't think it's dying."

Decisions on whether to favor an active or passive approach come at a time when both plan sponsors and managers are seeking ways to minimize risk following a decade of interest rate volatility. During the past 10 years, government interest rates ranged from a low of 7.2% to a high of 15.23%, according to Salomon Brothers Inc. Corporate interest rates ranged from 8.25% to 16.5% during the decade.

While some sponsors opt for structured accounts to cover liabilities, others seek a more active approach as a bulwark against market volatility. Some, however, want a hybrid of the two approaches, setting certain parameters of activity within a structured account.

A slight shift from strict active approaches has been detected during a five-year period in publicly reported searches for active fixed-income managers.

Deanna Frederick, assistant consultant with Eager & Associates, Louisville, Ky., found the percentage of active fixed-income managers sought by plan sponsors from 1984 to 1988 remained relatively the same, although the amount of money placed with those sponsors declined. In 1984, active fixed-income managers comprised 20% of the managers sought in all asset classes; in 1988, 18%. During the same period, the amount of assets placed with those managers declined to $6.7 billion or 20% of assets in tracked searches from $7.3 billion or 33% in 1984.

Managers, however, say they are under no pressure from sponsors to offer passive strategies.

"I know indexation has redeeming value in stock, but I can't see a reason to ever use a passive approach to the bond market," said Edward Sporl, chief financial officer and senior vice president for fixed income at Seibel Capital Management Inc., Larkspur, Calif.

"Every so often, a consultant raises the issue. But the basic idea we are selling in the bond portion of the market is there is a virtue in low volatility."

Business has boomed for Seibel in the past five years. The firm, which manages only active fixed-income accounts, had $6.4 million in assets under management in December 1983; In December 1988 the figure was $988.6 million. Currently it has $1.24 billion under management.

For 10 years ended Dec. 31, 1988, Mr. Sporl said Seibel has had a compound annualized return of 12.6%, compared with 10.9% for the Shearson Lehman Hutton Government/Corporate Bond Index.

"We manage the portfolio to produce low volatility," Mr. Sporl said. "Once we see the market has troughed out, we shorten securities to reduce volatility. Historically, that has been a strategy that worked. It takes you out of negative volatility."

The other element that loomed large in the past 10 years is direct government intervention in the credit market. "By being short during times when there may be some direct intervention, we reduce the chance of having volatility in the market," he said.

Billy Williams, a principal with STW Fixed Income Management Inc., Santa Barbara, Calif., agrees the market is less efficient and volatile. "This is the time to do well in active strategies."

He said the company has managed to be successful during the decade of volatility by not timing

Continued on page 15

Execs pass

B. Hamilton

C. Hinkle

C. Webb

R. Wohlert

G. Patterson

Continued from page 13
curities with maturities of less than five years. Some $500 million of Prime Capital's assets are in a straight Salomon BIG strategy.

Also late last year, the New York City Retirement Systems tailored its bond investments to a similar long-duration index developed by Shearson Lehman Hutton Inc., New York (*P&I Age*, Dec. 12).

Those investments now amount to $20.5 billion of the systems' $33 billion total assets, said Beverly Hamilton, deputy comptroller. The index suits the systems' long-term liabilities and will allow a pickup of 60 basis points of return a year, she said.

The $17.5 billion Florida State Board of Administration, Tallahassee, has had a duration-matched fixed-income program for several years, said Cliff Hinkle, executive director. The fund has about 43% of its assets in fixed income, all in the duration-matched strategy and largely managed in-house, he said. "We're very much sticking to the fundamentals we've been successful with," he said.

Some other funds use duration differently. The $3.7 billion Tennessee Consolidated Retirement System, Nashville, uses an active, quantitative fixed-income model that makes duration shifts in liquid U.S. Treasury securities, attempting to find anomalies in yield spreads, said Charles Webb, chief investment officer. The fund has used this approach for some time, he said.

On the dedicated side, Southwestern Bell Corp., St. Louis, set up a dedicated portfolio a few years ago to cover liabilities for retirees, and has added to it as needed, said Roger Wohlert, managing director-finance. The dedicated fund now accounts for about 30% of the company's $6.8 billion in pension assets and covers all retirees through 1987, he said.

Southwestern Bell probably won't add to the dedicated portfolio this year, because it hasn't had enough retirees since 1987 to make a major difference in liabilities and because interest rates have been coming down, Mr. Wohlert said. "It's always nice, if you're dedicating, to lock in a higher rate," he said.

Russell P. Flynn, manager-pension fund investments at Chrysler Corp., Highland Park, Mich., said the drop in rates leads him to believe there won't be a major new wave of dedications.

He added the Chrysler fund is into active bond management, focusing on maturities. "We're still getting a lot of recommendations to stay in the two- to five-year (maturity) range," he said. Perhaps later this year, there will be an opportunity to go longer, he said. Chrysler has about 45% of its $4.1 billion pension fund in fixed income.

The $6 billion South Carolina Retirement System is buying in the four- to seven-year maturity range because the yield curve is so flat, said Grady L. Patterson, state treasurer. The fund is 100% in fixed income; with longer bonds purchased in previous years, its average maturity is 12 to 13 years, he said.

Some executives have doubts about investors' ability to time the bond market. Mr. Tanner said he expects continued interest in bond indexing because of this factor. He also expects to see increased use of longer-duration indexes.

Ms. Hamilton said customized indexes are becoming more popular: "It's relatively easy to create an index that meets your needs, rather than just buying one off the shelf."

Mr. Flynn agreed indexing in general is attracting investors, but he still believe active management can beat the fixed-income market, where he said there are more mispricings than in the stock market.

Several executives, including Messrs. Flynn and Webb, said their funds have never used high-yield bonds. Mr. Webb predicted other pension investors likely will continue to use those instruments, unless there's a major default or federal tax laws are changed to remove advantages for companies to issue junk bonds. ■

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Dana offers GIC option

BROOKFIELD, Wis. — Dana Investment Advisors, primarily a fixed-income manager, now has a commingled guaranteed investment contract fund.

Donald J. Moore, senior vice president, said the fund will be offered to Dana's clients, primarily 401(k) plans that want to offer participants a GIC option.

The fund will be managed by LaSalle National Bank, Chicago.

"The LaSalle fund is a commingled fund using 22 to 25 issuers, and we have adopted their fund as part of our offering," he said.

He said only one client has signed up for the GIC fund so far, but others are considering adding the option.

Dana, which also offers equity management, runs about $350 million, of which $280 million is tax exempt.

Consumer stocks take lead

By Trudy Ring

KANSAS CITY, Mo. — Stocks related to consumer spending led the equity market in the second quarter, while telephone bonds outperformed other fixed-income sectors, according to DeMarche Associates Inc., Kansas City.

Consumer spending stocks advanced 12.7% in price in the quarter, while the Standard & Poor's 500 Stock Index had a price gain of 7.8%. The index had a total return of 8.8%. Except where noted, stock performance figures are price only.

The consumer spending sector advanced 32.9% in price in the year ended June 30, while the index was up 15.7%. The S&P 500's total return for the year was 20.5%. The sector includes companies in the food and beverage, tobacco, media, retail, lodging and restaurant industries.

Stocks responsive to interest rates made up the next best-performing sector. These stocks, including utilities and financial services companies, gained 10.8% in the quarter. For the year, they were up 21.7%.

Basic industry stocks gained 5.5% in the quarter and 6.5% on the year. This category covers the metals, automotive, transportation and building materials industries.

Technology stocks advanced 4.1% in the quarter and 3.3% for the year. This sector includes the aerospace, drug, electronics and office equipment industries.

Energy stocks had the quarter's poorest performance, gaining 2.2%. They were up 12.1% for the year. This sector is made up of domestic and international oil companies and oil service and equipment providers.

The 10 best-performing industries were lodging and restaurants, up 23.6%; media, up 19.1%; finance, up 17.1%; food packaging and processing, up 15.9%; electronic equipment, up 14.3%; textiles-products and apparel, up 14.2%; gas utilities, up 14.1%; telephone companies, up 12.9%; beverages, up 12.7%; and tobacco, up 12.5%.

The 10 worst-performing industries were containers, down 8.8%; automotive-cars and trucks, down 0.2%; international oil, up 0.9%; steel, up 1.6%; trucking, up 1.8%; chemicals, up 1.8%; aerospace, up 2.1%; paper, up 2.6%; aluminum and copper metals, up 2.7%; and office equipment, up 3.1%.

The top individual stocks were **Cullinet Software Inc.**, up 72.5%; **Hilton Hotels Corp.**, up 70.9%; **Holiday Corp.**, up 68.2%; **Kaufman & Broad Home Corp.**, up 63.9%; **Avon Products Inc.**, up 56.8%; **Campbell Soup Co.**, up 50%; **Harcourt Brace Jovanovich Inc.**, up 46.8%; **Kroger Co.**, up 44.1%; **Carter Hawley Hale Stores Inc.**, up 40.9%; and **Federal National Mortgage Association**, up 39.8%.

DeMarche also analyzes stock performance by quality, earnings growth and yield, grouping stocks in quartiles according to each factor. As ranked by quality, based on numerous balance sheet variables, superior-quality stocks had the quarter's best performance, advancing 10.5%.

As measured by growth, stocks with low, stable growth gained the most, 13.7%. As ranked by yield, those in the lowest yield quartiles gained the most in price, 12%.

In the bond market, telephone issues had the quarter's best return, 9.8%. The DeMarche Pension Fund Bond Index of more than 6,000 issues returned 7.7% in the quarter. Bond figures are total return.

Telephone bonds also led for the year ended June 30, returning 15.1%. The index returned 12.7% for the year.

U.S. government bonds had the quarter's second best return, 8.7%. They were up 13.5% for the year.

Utility bonds returned 8% in the quarter and 13.9% on the year. Canadian issues were up 7.8% for the quarter and 13% for the year.

Bonds issued by industrial companies returned 6.7% in the quarter and 11.7% for the year. Financial issues had a 6.6% return for the quarter and 11% for the year.

Yankee and foreign bonds, which led in the first quarter, were last in the second, returning 5.2%. They were up 10.9% for the year.

As ranked by quality, AAA rated bonds outperformed other categories, returning 8.5% for the quarter. As measured by maturity, those with maturities of 10 to 20 years had the best return, 9.1%. As rated by quality and maturity combined, AAA bonds with maturities of 10 to 20 years outperformed other categories with 9.8%. ■

Management firm started by 2 women

CHICAGO — Barbara L. Bowles, formerly corporate vice president for investor relations at Kraft Inc., Glenview, has formed The Kenwood Group Inc., Chicago, a minority-owned equity management firm.

Ms. Bowles will be president and treasurer of the firm. Joining her will be Barbara Jenkins, who will be vice president, equity portfolio manager and corporate secretary.

The firm's investment strategy will be value-oriented, Ms. Bowles said. It will focus on such factors as companies' cash flow and price-earnings ratios, but also will try to anticipate management decisions and their effect on value. The firm will concentrate on companies in the capitalization range of $200 million to $5 billion.

So far, the firm has about $200,000 under management, all for individuals, but it will be marketing to institutions as well.

Ms. Bowles was with Kraft for four years. Before that, she was assistant vice president and director of financial relations for Beatrice Cos. Inc., Chicago, and vice president-trust investments at First National Bank of Chicago.

Ms. Jenkins previously was manager of investor relations for International Minerals & Chemical Corp., Northbrook. She also has 11 years' experience as a senior investment analyst and officer for Bank of New York and Harris Trust and Savings Bank, Chicago. ■

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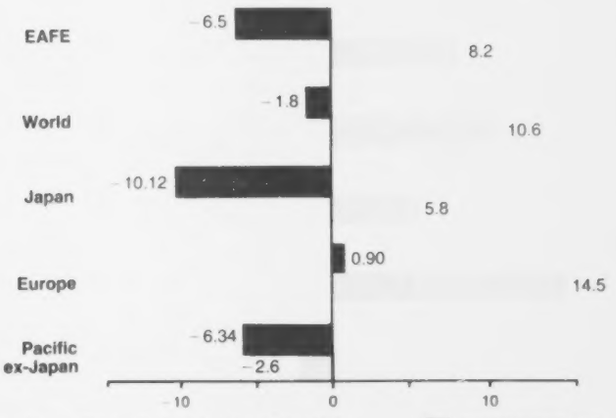
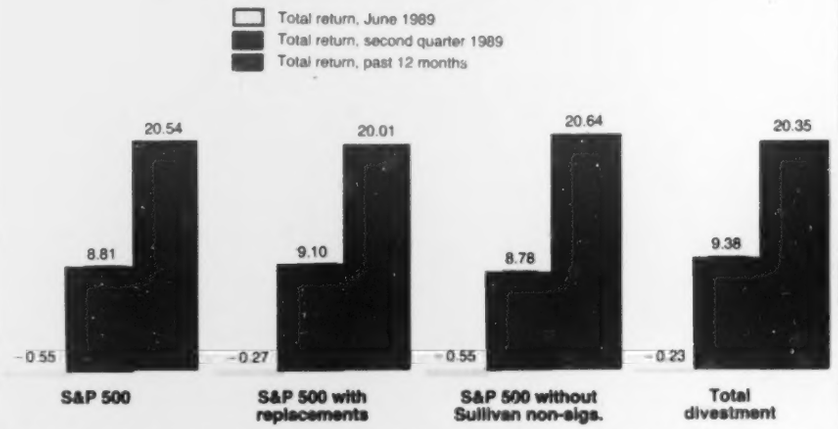
STATISTICALLY SPEAKING

Morgan Stanley Capital International worldwide indexes



Source: Morgan Stanley Capital International, New York
Indexes are in U.S. dollar terms without dividends reinvested

South Africa Free Index



S&P 500 with replacements: replaces a South Africa-related company with next largest company in the industry. **S&P 500 without Sullivan non-signatories:** excludes 6 companies, no replacements **Total divestment:** eliminates all companies with South Africa involvement, no replacements.

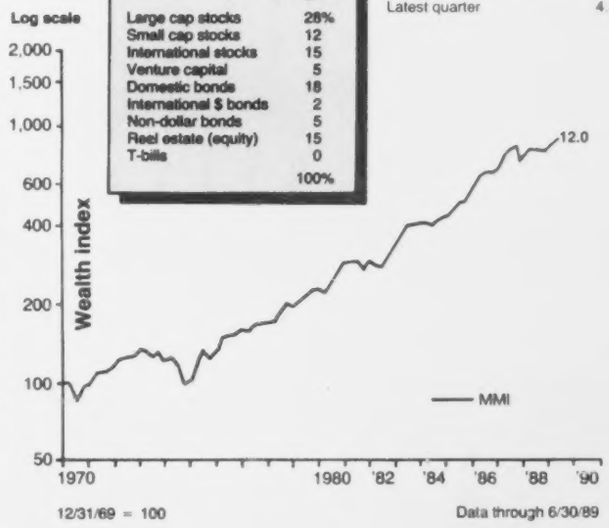
Source: Wilshire Associates, Santa Monica, Calif.

Multiple Markets Index

The Multiple Markets Index is a benchmark for total portfolio returns. It is composed of eight asset classes used by retirement plan executives; it is calibrated to reflect the same degree of risk of the typical pension portfolio; it uses passive fixed policy weights; and it represents the individual asset classes by the broadest and most complete market return data available.

Weights	
Large cap stocks	28%
Small cap stocks	12
International stocks	15
Venture capital	5
Domestic bonds	18
International $ bonds	2
Non-dollar bonds	5
Real estate (equity)	15
T-bills	0
	100%

Five-year annualized return	17.7%
One-year return	13.1%
Latest quarter	4.3%

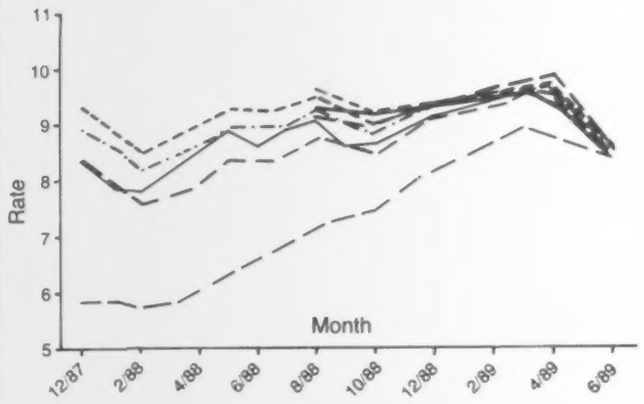


12/31/69 = 100
Data through 6/30/89

Source: First Chicago Investment Advisors, Chicago

Summary of average GIC & BIC data vs. market yields

(Bullet, compound $1 million contract)



3-year GIC — 90-day T-bill — 3-year BIC
5-year GIC — 6-year Treasury — 5-year BIC
7-year GIC — 7-year BIC

Source: William M. Mercer Meidinger Hansen Asset Planning Inc.

Second quarter 1989 returns

	Russell 3000®	Russell 1000®	Russell 1000® by market capitalization				Russell 2000®
			Large	Medium/large	Medium	Medium/small	
Technology	6.9%	7.1%	7.1%	7.1%	8.9%	4.4%	5.6%
Health care	6	6.2	5.5	5.1	10	11.1	4.1
Consumer discretionary	12.6	13	13	13.1	13.8	12.2	9.2
Consumer staples	13.6	13.6	14	15.2	10.4	9.5	12.3
Integrated oils	3.5	3.5	3.5	3.2	6.9	-1	-13.3
Other energy	9.3	9.2	NA	4.2	14.1	10.2	9.6
Materials and processing	2.9	2.9	0.3	5.3	2.3	2.6	2.6
Producer durables	6.9	7	10.5	5.9	5.9	7.1	6.1
Auto and transportation	4.3	4.6	1.6	5.5	8.2	4.1	0.6
Financial services	9	9.2	5.3	10.1	9.6	9.3	6
Utilities	13.9	14	13.8	14.3	13.4	14.5	12.2
Total	8.8	9	8	10.1	9.4	8.5	6.4

Source: Frank Russell Co., Tacoma, Wash.

GIC yields fall with rates

By Curtis Vosti

Yields on insurance company guaranteed investment contracts dropped back below double digits in the second quarter, while spreads between them and comparable Treasury instruments fluctuated.

While some GIC rates had soared above 10% with the inflationary pressures by the start of the second quarter, they tumbled with the interest rate fall during the quarter.

"In fact, overall rates fell anywhere from 1.2% to 1.7% between mid-March and the end of June, depending on the duration, for the high quotes each week, as the market responded to diminishing concerns about inflation and a slowing economy," according to a publication from Fiduciary Capital Management Inc., Woodbury, Conn.

According to Sharon Morell, a senior contract negotiator with Morley Capital Management Inc., Lake Oswego, Ore., average GIC rates at the end of the second quarter fell to between 8.25% and 8.6%.

"But as rates have fallen, we have seen increasing spreads, particularly in the longer contracts," she said.

The GIC curve steepened slightly during the quarter as the spread between one- and five-year GICs widened to 30 basis points from 15 basis points in March, Ms. Morell said.

John Knight, president of Lamberson-Knight GIC Inc., a Short Hills, N.J., GIC brokerage, said the lower yields have prompted buyers to be more interested in three-year than five-year contracts.

"Since the rates are below 9%, buyers have shortened up," he said. He noted, however, five-year GICs still were being bought as a hedge.

He said the capacity problems of years past are not a factor anymore because insurance companies and buyers are going to market more than once a year.

The Fiduciary Capital Management publication, GIC Update, said although banks have helped meet the demand of guaranteed contracts, there still is room for caution.

"While banks continued to be aggressive in pricing shorter duration BICs, the congressional debate regarding FDIC coverage caused plan sponsors to think again about the strength of banks," according to the publication.

"We continue to believe it is inappropriate to place undue emphasis on the presence of FDIC insurance, since the underlying quality of the institution should be paramount to any BIC investment decision."

Insurance company rate quotations on representative five-year, single deposit, simple-interest, $1 million GICs as of June 30, unless otherwise noted, and March 30, as provided by Lamberson Knight and GIC Inc., a Beaverton, Ore., GIC manager, are:

- Allstate Life Insurance Cos., Northbrook, Ill.: June 30, 7.85%; March 30, 9.63%.
- American United Life Insurance Co., Indianapolis: 8.3%; 9.69%.
- Canada Life Assurance Co., Toronto: 8.49%; 9.91%.
- CNA Insurance Co., Chicago: 8.54% (June 27); 9.64%.
- Confederation Life Insurance Co., Atlanta: 8.62%; 9.95%.
- Connecticut Mutual Life Insurance Co., Hartford, Conn.: 8.35%; 9.7%.
- Continental Assurance Co., Chicago: 8.44%; 9.79%.
- Crown Life Insurance Co., Toronto: 8.22%; 9.99%.
- Executive Life Insurance Co., Los Angeles: 8.69%; 9.98%.
- Great West Life Insurance Co., Denver: 8.15%; 9.59%.
- Hartford Life Insurance Co., Hartford, Conn.: 8.39%; 9.89%.
- Home Life Insurance Co., New York: 8.34%, 9.68%.
- John Hancock Mutual Life Insurance Co., Boston: 8.44%; 9.79%.
- Life Insurance Co. of Georgia, Atlanta: 8.6% (June 27); 9.9%.
- Life Insurance Co. of Virginia, Richmond: 8.41%; 9.72%.
- Lincoln National Pension Insurance Co., Fort Wayne, Ind.: 8.62% (June 27); 9.93%.
- Massachusetts Mutual Life Insurance Co., Springfield: 8.3%; 9.85%.
- Minnesota Mutual Life Insurance Co., St. Paul: 8.58%; 9.99%.
- Mutual Benefit Life Insurance Co., Newark, N.J.: 8.18%; 9.8%.
- Mutual of New York, New York: 8.28%; 9.77%.
- New England Mutual Life Insurance Co., Boston: 7.97%; 9%.
- New York Life Insurance Co. New York: 8.45%; 9.9%.
- Northwestern National Life Insurance Co., Minneapolis: 8.26%; 9.92%.
- Ohio National Life Insurance Co., Cincinnati: 8.6%; 10%.
- Pacific Mutual Life Insurance Co., Newport Beach, Calif.: 7.95%; 9.24%.
- Pan American Life Insurance Co., New Orleans: 8.59%; 9.89%.
- Penn Mutual Life Insurance Co., Philadelphia: 8.33%; 10.02%.
- Phoenix Mutual Life Insurance Co., Hartford: 8.37%; 9.66%.
- Principal Mutual Life Insurance Co., Des Moines, Iowa: 8.31%; 9.56%.
- Provident Mutual Life Insurance Co., Philadelphia: 8.39%; 9.76%.
- Provident National Life Assurance Co., Chattanooga, Tenn.: 8.06%; 9.51%.
- Southwestern Life Insurance Co., Dallas: 8.43%; 9.89%.
- State Mutual of America, Worchester, Mass.: 8.15%; 9.75%.
- Transamerica Life Insurance Co., Los Angeles: 8.4%; 9.99%.

William M. Mercer Meidinger Hansen Asset Planning Inc., Chicago, surveys insurance companies for rate quotations and provided the following summary of various bullet GICs for June:

- Three-year, $1 million, compound: high, 9.29%; low, 8.05%; average 8.52%.
- Three-year, $1 million, simple: high, 9.29%; low, 8.06%; average, 8.53%.
- Five-year, $1 million, compound: high, 9.32%; low, 8.08%; average, 8.63%.
- Five-year, $1 million, simple: high, 9.32%; low, 8.09%; average, 8.62%.
- Seven-year, $1 million, compound: high, 9.61%; low, 8.15%; average, 8.67%.
- Seven-year, $1 million, simple: high, 9.32%; low, 8.14%; average, 8.66%.
- Three-year, $5 million, compound: high, 9.29%; low, 8.16%; average, 8.59%.
- Three-year, $5 million, simple: high, 9.29%; low, 8.14%; average, 8.59%.
- Five-year, $5 million, compound: high, 9.32%; low, 8.14%; average, 8.67%.
- Five-year, $5 million, simple: high, 9.32%; low, 8.24%; average, 8.67%.
- Seven-year, $5 million, compound: high, 9.32%; low, 8.3%; average, 8.71%.
- Seven-year, $5 million, simple: high, 9.31%; low, 8.2%; average, 8.72%.

Dietrich & Asssociates, a GIC brokerage in Blue Bell, Pa., provided the following rate spread data between a $1 million, five-year, simple-interest GIC and the average Treasury security of the same maturity during the second quarter:

- April 3: GIC, 9.85%; Treasury, 9.53%;
- May 1: 9.65%; 9.15%; and
- June 1: 9.2%; 8.75%.

Mercer Meidinger Hansen also surveys banks for rate quotations on their guaranteed instruments. Rate quotations for one- and three-year bullet BICs for June were:

- One-year, $1 million, compound: high, 9.07%; low, 8.13%; average, 8.67%.
- One-year, $1 million, simple: high, 9.07%; low, 8.44%; average, 8.77%.
- Three-year, $1 million, compound: high, 9.11%; low, 8.12%; average, 8.64%.
- Three-year, $1 million, simple: high, 9.13%; low, 8.51%; average, 8.76%.
- One-year, $5 million, compound: high, 9.1%; low, 8.13%; average, 8.74%.
- One-year, $5 million, simple: high, 9.12%; low, 8.49%; average, 8.84%.
- Three-year, $5 million, compound: high, 9.16%; low, 8.12%; average, 8.69%.
- Three-year, $5 million, simple: high, 9.18%; low, 8.61%; average, 8.81%. ■

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FINANCING

Storage Technology Corp. has shelved a refinancing plan designed to clear debt and broaden its investor base.

StorageTek puts new plan on hold

By Marlene Givant Star

LOUISVILLE, Colo. — Doldrums in high-technology stock prices have forced Storage Technology Corp. to postpone plans for an innovative $330 million triple-decker refinancing package that was intended to wipe away debt and restrictive covenants incurred when it emerged from Chapter 11 in mid-1987.

The refinancing, which was to include two public offerings and a real estate financing, also was designed to broaden the computer information storage and retrieval company's equity base and double institutional ownership of the company's stock.

As a result of withdrawal of the refinancing plan, the company incurred a $1.6 million expense for legal fees, printing fees and other costs incurred for the proposed offering. By refinancing, the company would have avoided increasing interest and sinking fund payments that were slated to begin in 1991 under the indenture. An estimated $116 million in cash flow would have been saved or deferred through 1996, according to Moody's Investors Service, New York.

Postponing the refinancing should not pose an immediate burden to the company. "It won't be too onerous to begin with. They have plenty of cash reserves, but as a permanent solution they should do something," said Byron N. Walker, assistant vice president and senior analyst of technology companies at Moody's. If stock prices of technology companies recover, Storage Technology might reinstate the refinancing, which was to have taken place in mid-July.

"Our plans are to continue to pursue that avenue but we need to wait for market conditions for our common stock to improve," said Robert Kali, director of treasury

Continued on page 32

Moving in the middle

Medium-term notes flourish

By Marcia Parker

NEW YORK — Wall Street's product pipeline is filled with huge medium-term note programs filed by a host of corporations eager to take advantage of falling interest rates, a keen investor appetite for shorter-term corporate paper substitutes and strong foreign investor demand for dollar-denominated issues.

Investment bankers said the medium-term note market experienced a sharp resurgence of activity in the second quarter. New public filings soared to a record $40.3 billion, virtually double the $20.5 billion registered in the first quarter, according to Merrill Lynch Capital Markets.

Many issuers are repeat users of medium-term notes like General Motors Acceptance Corp. and General Electric Capital Corp., both of which are reloading previous programs to meet their continuing funding needs.

The numbers do not include private placements of medium-term notes, which also are growing. Merrill Lynch is one of the biggest players in medium-term notes, but since the market started less than two years ago nearly every investment bank on Wall Street has claimed a share of the lucrative market.

The most recent filings in the pipeline include $5 billion by GMAC, $500 million by the Bank of Tokyo, $500 million by PaineWebber Inc., $500 million by Sears, Roebuck & Co., $470 million by Westinghouse Credit Corp., $450 million by Pitney Bowes Credit Corp. and $300 million by General Electric Capital.

But registrations don't mean securities are being issued. The filings are just a signal that companies will go to market when the time is right. Unlike conventional corporate debt — offered to investors on an underwritten basis in a single offering — medium-term notes are brought to market on an agency basis as market conditions and issuer need dictate.

New continuously offered medium-term note programs (issued worldwide)

	1987	1988	1989 1st qtr.	1989 2nd qtr.
Volume ($ bils.)	$48.9	$89.5	$20.5	$40.3
Average size ($ mils.)	379	428	570	600
Distribution (% of total)				
Industrial	7.6%	16.4%	6.5%	8.1%
Non-bank finance	46.4	34.4	19.8	19.8
Utility	3.2	2.5	1.6	4.0
Agency	7.2	10.1	9.8	2.5
Thrifts	7.5	10.7	20.5	3.0
Banks	28.2	25.9	41.9	38.8
Domestic	12.3	11.6	16.6	22.2
Foreign	15.9	14.3	25.3	16.6
First-time issuers	52.5	40.1	44.2	32.4
No. of programs				
Total	129	209	36	67
First-time issuers	80	107	17	29

Source: Merrill Lynch Capital Markets, New York

"There is a lot of paper on the shelf," said Dwight Churchill, vice president, Prudential Fixed Income Advisors, Newark, N.J., and a big buyer of medium-term notes.

The second quarter rebound in medium-term notes included a sharp increase by finance companies and banks. The two institutions combined accounted for more than 80% of the total. Underscoring the heavier use of the medium-term notes market by auto finance companies is the need to fund their aggressive loan incentive programs in effect during the quarter. Banks also relied more heavily on the medium-term note market relative to other short-term sources of funds.

The $60.6 billion of new filings in the first half of 1989 exceeded the corresponding 1988 volume by more than 30% and is on track to shatter the full-year record of $89.5 billion set in 1988, according to Robert Schwartz, vice president and senior financial economist, Merrill Lynch Capital Markets.

At the current pace, Mr. Schwartz said, the total for 1989 will more than triple the volume of new filings in 1986, when the medium-term notes market emerged as a significant source of corporate finance.

Not only have new filings increased by 30%, the average size of new programs has increased considerably this year to $590 million from $428 million in 1988. With actual issuance up by less than 5% over last year's pace, this translates into a huge buildup of unused program capacity, Mr. Schwartz said, indicating issuers are prepared to take advantage of falling interest rates.

The sharpest drop in rates has occurred in the short to intermediate segment of the curve where issuance is the heaviest.

A vacuum has been created by the scarcity of underwritten debt in this maturity range because the bulk of recent bond offerings has been in the more than 10-year sector. Institutional investors are hungry for conventional corporate debt substitutes in the short end of the yield curve. Strong foreign demand for dollar-denominated issues is propelling the growth of global programs.

A number of recent filings, in-

Continued on page 34

UPDATE

Credit quality dipping

NEW YORK — The credit quality of U.S. corporations and financial institutions declined significantly during the first half of 1989 following an increase during the first quarter, the two major credit rating agencies report.

The agencies attributed the falling credit quality to special events such as debt-financed mergers and acquisitions and weakness in real estate and high-technology industries.

Moody's Investors Service said it lowered credit ratings on 124 U.S. companies during the period, vs. 60 that were upgraded. In dollar terms, $67 billion of debt was downgraded, while $43 billion was upgraded. The special events — mainly debt-financed mergers, acquisitions, equity buybacks and leveraged buy-outs — accounted for 39 of the 76 downgrades in the industrials sector.

Standard & Poor's Corp. downgrades of $30.1 billion edged out upgrades of $27.1 billion. The changes in credit quality affected a broad cross-section of industrial issuers and spanned the entire credit quality spectrum.

Executive appointed

CHICAGO — John Cavalaris, former vice president at AT Commercial Corp. and Fidelcor Business Credit Corp. in Chicago, has been named vice president of the new First Westinghouse Capital Corp. office in Chicago.

First Westinghouse, an affiliate of Westinghouse Credit Corp., provides mezzanine debt financing and equity to middle-market businesses for expansions and acquisitions.

Mr. Cavalaris will work with investor groups, commercial and investment banks on the financing side.

He also will work with middle-market companies in industries

Evaluating event risk

NEW YORK — Standard & Poor's Corp. has initiated a new service to evaluate bondholders' protection against event risk.

S&P's event risk covenant rankings assess the degree of protection provided in the bond indenture against a sudden and dramatic decline in credit quality resulting from takeovers.

The ranking system is based solely on S&P's analysis of bond indenture provisions; no opinion of the likelihood or potential of such events occurring is implied.

The five event risk categories created by Standard & Poor's are strong protection, significant protection, some protection, weak protection and insignificant or no protection.

The focus will be on investment-grade, non-convertible bonds sold in the United States by U.S. industrial companies. The first companies have been ranked;

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UPDATE

Continued from page 31
and changing rankings as they occur.

Rankings will be expanded later to other sectors.

Conning gets exec

HARTFORD, Conn. — John C. Lang, formerly managing director in the investment banking division of Merrill Lynch Capital Markets, New York, has joined Conning & Co. as an executive vice president and director.

Mr. Lang will head Conning's corporate finance and consulting operations, which are being consolidated as the firm sharpens its emphasis on merchant banking activities.

At Merrill Lynch, he primarily provided services to the insurance industry.

Prior to joining Merrill, he was Aetna Life & Casualty's treasurer and vice president.

Merchant bank set up

NEW YORK — Two former Prudential-Bache Capital Funding executives have set up The International Harvest Group of Delaware Ltd., a New York merchant banking firm specializing in the middle market.

The principals are Eugene Wong and Richard Groberg.

Mr. Wong was a managing director and head of the high-yield securities group at Prudential-Bache Capital Funding in New York; Mr. Groberg was a vice president in the high-yield group.

To capitalize on their experience in the high-yield market, IHG will focus on subordinated debt financings in the $50 million to $200 million range, leveraged acquisitions in the $100 million to $400 million range, selected turnaround buy-outs and international advisory and cross-border merger and acquisition activity.

At Pru-Bache, Raymond Lemanski and Salvatore Cioffalo, both managing directors, were named co-heads of the high-yield securities group.

Medium-term

Continued from page 31
cluding those by GMAC and Westinghouse Credit, included substantial European tranches.

According to a new study by Moody's Investors Service Inc., New York, the market for European medium-term notes will continue to expand over the next two years. To date, Moody's has rated about 65%, or $23 billion, of the dollar-denominated market volume.

Much of the future growth, according to Moody's, will be stimulated by investor demand. The rating agency expects demand will continue to exceed the supply of highly rated paper despite international investors' continuing concerns regarding disclosure, market liquidity and credit risk, which stem from the still small market. Some of those concerns will likely ease as the available pool of European medium-term note programs grows and investment criteria are established.

Moody's also believes more issuers will be attracted to the European medium-term note market because of its perceived advantages over traditional securities.

For issuers, a major advantage is the greater flexibility in selling the issues to investors than with a conventional debt offering. Medium-term notes also can be cheaper because issuers can get lower rates in exchange for meeting the maturity requirements of certain investors.

For investors, medium-term notes offer asset-liability matching, credit diversification, liquidity and the ability to negotiate such features as size, currency denomination and coupon structure.

"For issuers and investors the product spells flexibility," said Jaclin Singer, vice president, marketing, Merrill Lynch.

Investors say that as the primary medium-term note market has grown, so has the secondary market. Trading has picked up significantly, which draws even more investors. U.S. investors include insurance companies and non-financial companies as well as money managers and pension funds.

Mr. Churchill said he has been buying medium-term notes from household-name companies such as Ford Motor Credit Corp., GMAC, E.I. du Pont de Nemours & Co. Inc., and Commonwealth Edison Co. "I use them as replacements for corporate notes. They offer the same liquidity, especially since the conventional corporate note market isn't very liquid right now. And they are offered as non-callable securities," he said.

Mr. Churchill also said he was buying up utility medium-term notes to give him exposure to that sector because there is a dearth of conventional utility paper. "That way I don't have to bid up the securities that do exist," he added.

Among foreign investors, the Japanese have recently stepped up their purchases in the two- to three-year sector, resulting in the posting of narrower spreads in this maturity range, the first narrowing of corporate spreads in the debt market in several weeks. ■

Companies feel special event sting

NEW YORK — Special events resulting mainly from corporate restructuring or litigation caused $154 billion of U.S. corporate debt in the U.S. and Eurobond markets to be downgraded an average of one letter category from 1984-1988, according to a study by Moody's Investors Service.

Moody's studied all special-event downgrades affecting U.S. companies during those years in light of the growing concern about event risk.

(Special events are mergers, acquisitions, takeovers or divestitures, capital restructuring or leveraged buy-outs. The risk that such a special event is likely to occur, thus causing immediate market-value losses and increased probability of future default losses to bondholders, is termed event risk.)

Special-event downgrades have caused serious declines in credit quality of U.S. corporations and losses to their bondholders in the past five years.

There were 284 special-event downgrades, affecting a total of 238 companies from 1984-1988, according to Moody's.

Each year since 1984, special events consistently have accounted for one-fifth to one-third of all downgrades of U.S. corporate issuers. On average, 30% of the 960 downgrades during the period were the result of special events, and 23% of the $750 billion of U.S. corporate debt downgraded was lowered because of events.

Viewed from the perspective of the total corporate market, events affected an average of 5% of U.S. issuers' outstanding rated debt annually in the U.S. and Euro markets during the five-year period.

Most special events took place in the industrial sector.

In total, Moody's ratings on some 40% of the U.S. industrials' outstanding debt were lowered during the period because of special events.

Mergers and acquisitions were by far the most common form of special event, followed by capital restructurings and litigation.

However, only a fraction of the outstanding debt involved was lowered to speculative grade.

By contrast, leveraged buy-outs caused 8% of special-event downgradings, but nearly all the debt involved fell to speculative grade as a result.

In all, Moody's found roughly two-thirds of the debt downgraded because of special events remained investment grade.

On a worst-case basis, Moody's estimates bondholders might have suffered immediate market-value losses of up to $2.7 billion annually since 1984.

The record year was 1988. That year, the total estimated losses — including those on the RJR Nabisco Inc. debt — reached $4.3 billion. ■

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PORTFOLIO MANAGEMENT

Real estate attitudes differ greatly

Pension fund executives' attitudes toward real estate

	Corporate	Public
Attitute toward increased real estate investments:		
Positive	40%	56%
Negative	32	18
Indifferent	28	26
Form of real estate ownership*:		
Direct ownership	26	41
Participating mortgages, limited partnerships, etc.	12	31
Commingled funds	63	43
Preference for future real estate*:		
Direct ownership	16	49
Participating mortgages, limited partnerships, etc.	15	25
Commingled funds	74	50
Do commingled funds overcome the disadvantages of real estate?		
Yes	57	34
No	22	32
Indifferent	21	32
Attractive features:*		
Income	30	35
Appreciation in value	42	66
Inflation protection	55	62
Diversification	80	79
Unattractive features:*		
Lack of liquidity	64	47
High risk	13	21
Special investment skills required	23	44
Property management requirements	12	37
Valuation/appraisal difficulties	51	50
No benefit from tax preferences	14	24

* May not total 100% because respondents could select more than one item.

By Clarence C. Elebash and Gregory C. Yost

Although real estate is a major portion of the nation's wealth, pension funds are not heavily committed to the ownership of real property.

Roughly 50% of the nation's assets are in real estate. Yet pension funds, a major source of long-term investment capital, have invested in aggregate less than 5% of their total assets to the investment class.

It remains to be seen if an almost token commitment to equity real estate by corporate and public pension funds will grow. The question arises as to the future of pension funds in real estate.

To find out the extent of pension fund participation and pension fund management's attitudes toward real estate equity, we surveyed executives and officials of both corporate and public pension funds.

For corporate funds, we sent surveys to executives at more than 514 large companies. We received responses from 327, or 64%, representing $350 billion in pension assets.

For public funds, we sent surveys to officials at 83 state and other public organizations. We received responses from 68, or 82%, from 44 states, representing $390 million in pension assets.

The replies provide the basis for the ensuing analysis and conclusions.

In sum, we found differing attitudes between corporate pension executives and public pension officers.

Corporate pension executives invest a higher percentage of their assets in real estate, 5.2%, compared with 3.4% for public funds. But the lead in terms of allocation could change.

Corporate pension executives are less inclined to add to their real estate investments than their public counterparts. Corporate executives are concerned about certain unattractive features, such a lack of liquidity and difficulties with valuations and appraisals. The lack of a tax benefit from depreciation, however, is not a major concern, apparently overcome by the structure of real estate deals with taxable investors. Corporate executives also have a stronger preference for commingled funds.

The overall conclusion is that corporate pension plans will increase their real estate investments at a modest pace. Diversification among asset classes is the most appealing feature of real estate investing. The use of commingled funds simplifies the real estate investment task, and their popularity will continue.

Of the corporate respondents, 285, or 87%, had policy statements authorizing real estate investments, and 232, or 71%, owned real estate. The average percentage invested in real estate equity of the funds that owned real estate was 5.2% of total assets, which was consistent with expectations. In dollar terms they held $18.2 billion, a small amount compared with the total value of U.S. real estate.

Clarence C. Elebash, left, is professor of finance, and Gregory C. Yost is associate professor of accounting and chairman of the department of finance and accounting, at the University of West Florida in Pensacola.

Of the public respondents, 65, or 79%, had policy statements authorizing real estate investments, and 52, or 63%, owned real estate. The average percentage invested in real estate equity of the funds that owned real estate is 3.4%, or $13.5 billion.

Diversification is the most attractive feature of real estate, the surveys found. Respondents also gave favorable ratings to income, potential appreciation and the inflation protection. Neither risk nor the lack of tax preferences is considered a serious difficulty, and special management expertise also does not appear to be a seri-

Continued on page 36

Reaping profits from the earth

Farmland a slow but sure winner

By Barton M. Biggs

American farmland is the best real estate investment at this time. In fact, the case is so compelling that, in my opinion, farmland competes with stocks and bonds.

Buy a farm and you may get rich slowly but more surely.

Vehicles for institutional investment in farmland are becoming available, and farmland investing could become a new asset category. I recommend that farmland be a major part of every real estate allocation.

As for other forms of real estate, I believe that over the next five to 10 years financial assets will outperform real estate. However, prudent diversification requires that every large portfolio have representation in real estate, and currently I am suggesting that its weighting be at the bottom end of my recommended 5% to 30% asset allocation range.

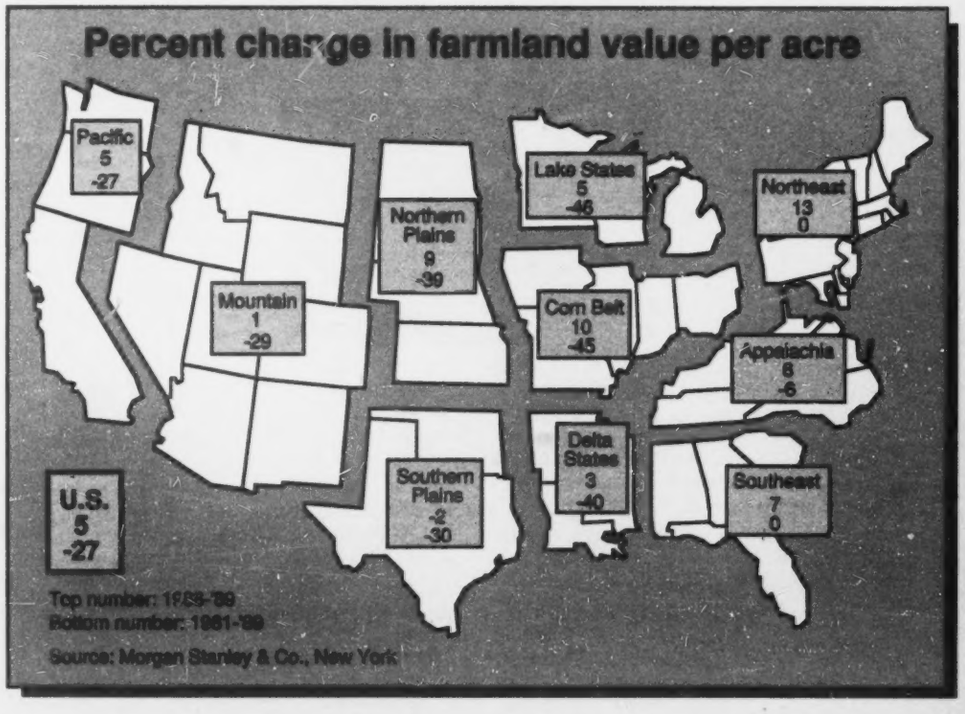
I don't pretend to know much about real estate, but I am influenced by what I hear from people like Laurence A. Tisch, chairman and chief executive officer of Loews Corp. and president and chief executive officer of CBS Inc., both of New York, and Samuel Zell, chairman, Equity Financial and Management Co., Chicago. I also recently read a

Generalizations in such a large and diverse industry are dangerous. And real estate, of course, is a matter of location and specific markets. But in general the commercial real estate market does not look attractive, with the possible exception of industrial space. Overbuilding and bad lending practices are the problems, and it may take a long time to cure them.

I have studied with considerable interest the investment possibilities of timberland, as some data suggest the returns have been good. However, Thomas P. Clephane, managing director and a colleague at Morgan Stanley, has convinced me timberland does not generate competitive cash returns or much appreciation unless you get very lucky. Prices of residential real estate are still rising at about a 5% rate nationally, but there are vast regional differences. Besides, there is no really good institutional vehicle for equity participation.

But farmland is compelling. I believe the bear market in farmland is over and an upsurge that will last for years is just beginning.

Although the yield on farmland today at about 6% to 7% does not equal that on government bonds, they aren't making any more farmland, and Washington does



asset category my colleagues and I follow that shows an actual decline in price for the 1980s. Recently, however, this bear market seems to have ended.

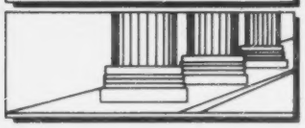
According to the Department of Agriculture, the recovery in farmland values that began about 18 months ago continued in the fiscal year ended Feb. 28, 1989. The per acre price rose 6% to $597 but is well under the high of $823 47% below the 1980 level.

I reiterate, however, that price trends are very different, depending on location. For the country as a whole, farmland value per acre for the year ended Feb. 28 was up 5%. But from its peak in 1981 to February 1989, it's down 27%.

Farmland values have increased for several reasons. Farmers' net cash income, despite the drought, nearly matched the record 1987 values was unchanged or slightly lower for most states, except in the West, where rents increased on crop land.

Furthermore, farm real estate debt kept falling and is now down 27% from the 1983 peak. The ratios of debt to equity and to net cash income declined in fiscal 1989, indicating an increase in the financial ability of some producers to buy land.

WASHINGTON



Restrictions on thrift plan mulled

A Democratic congressman pressed officials of the $3.9 billion Federal Retirement Thrift Investment Board to consider restricting investments in securities of companies that do business in South Africa and Northern Ireland.

Rep. Gary L. Ackerman, D-N.Y., chairman of the House Committee on Post Office and Civil Service subcommittee on compensation and employee benefits, asked whether limiting investments in such securities would pose difficulties for the 2-year-old fund.

The fund, which has 1.4 million participants, is growing at an $8 million a day clip, and is expected to reach $50 billion in assets by the year 2000.

Specifically, Mr. Ackerman referred to companies doing business in South Africa or those operating in Northern Ireland that do not subscribe to the equal employment guidelines of the MacBride Principles.

Francis X. Cavanaugh, executive director of the board, noted investment restrictions have been suggested to the fund since "day one."

He added that participants already had been informed of their options, so changing the rules now would not be fair to them. Also, he said, construction of a special portfolio would increase expenses to the fund.

Under the law, the fund provides three investment options: a short-term government securities fund; a Standard & Poor's 500 Stock Index Fund; and a bond index fund that tracks the Shearson Lehman Hutton Government/Corporate Bond Index.

No one discussed, however, the possibility of adding investment options.

Otherwise, legislators and witnesses at the July 25 hearing favored enactment of bipartisan legislation that would remove restrictions on investments in the stock and bond funds, as well as allow federal agencies to pay lost earnings to employees' accounts because of administrative errors made by their agencies.

Lifting investment restrictions could cause a surge of investments in the stock and bond funds, as well as increased fee income for Wells Fargo Investment Advisors, San Francisco, which manages those assets in pooled vehicles. (The government securities fund is internally managed.) Currently, the stock fund has only $27 million in assets; the bond fund has $11 million.

Federal law limits federal employees to investing up to 20% of their thrift-fund contributions in the stock and bond funds, increasing an additional 20 percentage points each year through 1992. Employer matching contributions have to be invested in the government securities fund until restrictions are phased out between 1993 and 1997.

The investment restrictions originally were put in place to avoid fluctuations in value from affecting the federal budget, but the Congress put the thrift fund off-budget last year.

The bill, H.R. 2514, is considered noncontroversial and is expected to be voted on in September.

Farewell serenade

Pension Benefit Guaranty Corp. employees bid a songful farewell to departing Executive Director Kathleen Utgoff and Deputy Executive Director Royal Dellinger.

In a tribute to their toils over returning three underfunded pensions plans to The LTV Corp., Dallas, a choir of PBGC attorneys sang "Restoration" to the tune of Handel's Hallelujah chorus.

"And we will litigate forever and ever," was perhaps the most revealing line in the song.

PBGC employees presented Ms. Utgoff with a new tennis racket and Mr. Dellinger a golf club — neither of which, it was pointed out, was made with steel.

Ms. Utgoff, who left the agency at the end of July, will join the law firm of Groom and Nordberg after Labor Day as an economist. She will perform various economic and policy analyses on insurance, tax and benefits issues.

Mr. Dellinger will stay on at the PBGC past his July 31 resignation date to ease the transition into the new administration. His future plans are undetermined.

Index support grows

Indexed government bonds would be studied by the Treasury Department in a provision tucked away in the House Education and Labor Committee bill.

Long advocated by former pension watchdog Robert A.G. Monks as a way to both ensure real rates of return to pension funds and finance the federal budget deficit, the idea apparently has gained support in the House labor panel.

The provision would require the Treasury Department to report by the end of 1990 on what changes would be needed to permit the federal government to issue bonds indexed to inflation, the demand for such bonds among private pension plans and individual retirement accounts, and what effect such bonds would have on financial markets and the federal budget.

Meanwhile, Sen. Tom Harkin, D-Iowa, sponsored an amendment to the Senate Labor and Human Resources Committee's budget bill that would require the General Accounting Office to study to what extent employers with fewer than 25 employees terminate their pension plans and recapture surplus assets. The study also would be due by the end of 1990. ■

Farmland sure

Continued from page 35

anese bought a lot of American farmland. In fact, half of all the 218,000 acres farmland they own in the United States was purchased last year.

Foreigners own 12.5 million acres, or 1% of the farmland in the United States. Investors from the United Kingdom and Canada are the biggest foreign holders, owning, respectively, 2.8 million acres and 2.5 million acres, or together 42% of all the acreage owned by foreigners.

The total acreage owned by all foreigners is down from the 16 million acres they owned at the peak of the farmland bull market when prime acreage sold at 25 to 35 times earnings. There was hostility then toward overseas investment, but some states like Iowa and California now have actually taken steps to make it easier for foreigners to control land.

As a straw in the wind, the Federal Reserve Bank of Chicago, in its May letter, reports that farmland values in its district are rising at a 10% year-over-year rate, with the pace quickening in the most recent quarter. This may be significant because the district, which incorporates Illinois, Indiana, Iowa, Michigan and Wisconsin, is the blue chip farm heartland of America. But it is still heterogeneous. In the last year, Iowa land prices are up 15% on average, but Wisconsin acres have risen a mere 1%.

Midwestern farmland is the best grain-growing acreage in the world, and America is by far the lowest cost agricultural producer in the world.

U.S. agriculture looks in good shape at this point, although as always, weather and moisture are uncertain. In grains, the stocks-to-use ratio is back to the same level that, in 1972, resulted in one of the greatest U.S. grain years of all time.

A recent survey showed 75% of all farm equipment dealers expect higher sales, and there is every indication that the farmer's confidence and financial condition are improving. Deere & Co., based in Moline, Ill., has reported huge gains both year over year and sequentially in sales of tractors and combines. ■

This article is excerpted with minor adaption from an analysis by Barton M. Biggs, chairman of Morgan Stanley Asset Management Inc., New York, and managing director of it parent company, Morgan Stanley & Co.

Real estate attitudes

Continued from page 35

ous problem.

Commingled funds are by far the most popular form of investment by corporate funds, accounting for 63% of the real estate assets.

As of early this year, 63% of the corporate respondents have a position in commingled real estate funds, and 74% prefer the commingled funds for future investments. A majority of corporate executives also believe commingled funds overcome the disadvantages of real estate equity.

Of their $18.2 billion in real estate, corporate funds allocated $11.3 billion to commingled funds, $4.8 billion to direct ownership and $2.1 billion to participating mortgages, limited partnerships and other types of equity investments.

Of the $13.4 billion total in real estate held by public funds, $3.8 billion was allocated to commingled funds, $3.9 billion to direct ownership and $5.8 billion to participating mortgages, limited partnerships and other types of

Corporate and public funds differ in their attitudes toward unattractive features of real estate. Corporate plans worry more about liquidity and are less concerned about the special investment and management skills required for real estate.

Because corporate and public pension officials operate in different environments, this could account for their differences on real estate equity. Corporate officers are less constrained by experience and political events. They have stronger financial backgrounds, and have more flexibility under the Employee Retirement Income Security Act of 1974 than do many public plans under the state laws.

A serious concern about the lack of liquidity, however, apparently is dampening corporate enthusiasm for additional real estate. State pension trustees, on the other hand, are more conservative and less venturesome than their private firm opposites, in part because state plans function in the political arena and private plans

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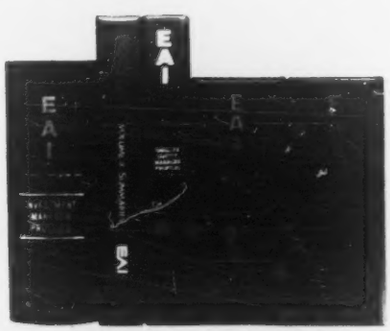

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INTERNATIONAL

Election results fuel Tokyo market

Yet analysts remain leery of long term

By Margaret Price

TOKYO — After the stunning July 23 elections in the upper house of Japan's Diet, followed by the resignation announcement of Prime Minister Sousuke Uno, the Tokyo stock market suddenly surged higher. Analysts cited widespread relief by investors, especially in Japan, that the election was over.

Many international money managers, however, still are not wildly impressed. Despite the market's sudden ebullience — said to be linked to heavy buying by cash-rich Japanese institutions — some investment managers are worrying about the effects of the next election, coming probably early next year, in the more powerful lower house of parliament.

Managers had already seen how destructive recent political scandals had been on the Tokyo market. While the Nikkei 225 Stock Index advanced 9% in local currency terms for the first six months of this year, the Japanese component of the Morgan Stanley Capital International Europe Australia Far East Index rose 1.9% in local currency terms, and fell 11.4% in U.S. dollar terms.

Analysts said Japan's political problems this year — such as the Recruit Cosmos scandal — were a major depressant on the country's stock market.

Some investors — such as SBC Portfolio Management International Inc., New York — already are thinking ahead to the next elections, which should determine whether the Liberal Democratic Party can remain in control.

"We think the Japanese market will do well for the short-term," said Hanspeter Ackermann, SBC's chief strategist, citing an oft-heard view among money managers.

But by the fourth quarter, he and many others expect renewed uncertainty about the election outcome to again dampen investors' enthusiasm.

SBC's strategy reflects that outlook. Mr. Ackermann said his firm

Continued on page 38

Top 50 managers of global accounts

Firm	$ million
1. Templeton Int'l	2,249
2. Batterymarch	1,161
3. TCW Global	1,012
4. WorldInvest	922
5. PCM Int'l	903
6. Dimensional Fund	885
7. First Chicago	778
8. Warburg Investment	708
9. Discount Corp./N.Y.	650
10. State Street Bank	431
11. Fiduciary Trust*	410
12. Kemper-Murray	398
13. Rowe Price-Fleming	306
14. Capital Guardian	302
15. Capital Research	262
16. Beutel, Goodman Int'l	255
17. County NatWest*	252
18. Philippe Investment	211
19. Lexington Mgmt.	210
20. Fidelity Int'l	200
21. Mercator Asset*	200
22. Roll and Ross	200
23. INVESCO MIM	198
24. Posthorn Global	193
25. J.P. Morgan	184
26. Burgess Capital	175
27. Massachusetts Financial	175
28. N.M. Rothschild	144
29. Bankers Trust	141
30. Morgan Grenfell Investment	141
31. Martin Currie	134
32. Globe Finlay	127
33. Van Eck Associates	125
34. IDS Int'l	112
35. Nikko Capital	104
36. Schroder Capital	100
37. Seaboard Investment	100
38. Scudder, Stevens & Clark	93
39. Grantham, Mayo, Van Otterloo	75
40. Marvin & Palmer	75
41. Brandes Investment	70
42. Smith Barney Global	66
43. Lombard Odier Int'l	62
44. Lazard Freres	58
45. Julius Baer	51
46. Interinvest	50
47. Citicorp	36
48. Putnam	31
49. Credit Suisse	30
50. Capital Mgmt. Int'l	29
Total	15,784

* as of Dec. 31, 1988
Ranking is based on U.S. institutional, discretionary, tax-exempt assets managed as of March 31.

Top 50 managers of international accounts

Firm	$ million
1. State Street Bank	5,153
2. Capital Guardian	3,153
3. Baring Int'l	2,383
4. J.P. Morgan	2,265
5. Morgan Grenfell Investment	2,263
6. GE Investments	2,174
7. First Chicago	2,155
8. Grantham, Mayo, Van Otterloo	2,036
9. Wells Fargo	1,954
10. Rowe Price-Fleming	1,809
11. Schroder Capital	1,800
12. Nomura Capital	1,517
13. Batterymarch	1,391
14. Chase Investors	1,217
15. Oechsle Int'l	1,084
16. N.M. Rothschild	827
17. Warburg Investment	825
18. Fidelity Int'l	800
19. Boston Int'l	798
20. Alliance Capital	786
21. Bankers Trust	781
22. WorldInvest	726
23. Scudder, Stevens & Clark	698
24. Mellon-Pictet	580
25. Julius Baer	572
26. Brown Brothers Harriman*	515
27. Posthorn Global	515
28. IDS Int'l	512
29. Mercator Asset*	500
30. Daiwa Int'l	482
31. Arnhold/Bleichroeder	480
32. Hill Samuel/Investment	389
33. G.T. Capital	388
34. Wellington Mgmt.	330
35. SBC Portfolio	328
36. PCM Int'l	314
37. Citicorp	302
38. Nikko Capital	276
39. ANB Investment	275
40. Capital Mgmt. Int'l	268
41. Investment Index	261
42. Aetna Capital	227
43. Boston Co.	224
44. Travelers	221
45. Marsh & Cunningham/Castegren	207
46. Globe Finlay	203
47. Walter Scott	200
48. Kleinwort Benson	194
49. Dunedin Fund	190
50. Lombard Odier Int'l	186
Total	47,734

* as of Dec. 31, 1988
Ranking is based on U.S. institutional, discretionary, tax-exempt assets managed as of March 31.

In the June 26 issue, the list of the Top 50 money managers by global account and international account assets was taken from universe of the Top 50 managers ranked by combined international/global assets. The charts above reflect the top managers by each type of account, drawn from the total universe of respondents.

LBOs take global tilt

Schroder amasses $1 billion from investors

By Marlene Givant Star

LONDON — Capitalizing on the appetite for substantial returns in Europe, Schroder Ventures has raised more than $1 billion for investments in country-specific leveraged buy-out funds.

Institutional investors worldwide, including the $2.6 billion Massachusetts Pension Reserves Investment Management Board, Boston; reportedly Strategic Investment Partners, Washington, on behalf of the World Bank pension fund, Washington; G.T. Venture Management, London, a

investments; and several other large pension funds and insurance companies, have invested in Schroder's leveraged buy-out funds, which span Europe, the United Kingdom and Canada.

Schroder might launch a European fund alongside its country funds as it expands its U.S. pension fund client base, and it plans to launch a West German management buy-out fund before next year. Schroder, believed to be the biggest leveraged buy-out fund manager in Europe, has bought more than 50 companies there.

Europeans refer to leveraged buy-outs as management buy-

ment of existing management, which would be called a management buy-in.

Many investors already are seeing the fruits of their investments. In May 1987, Schroder was the lead investor in a $52 million (100 million deutsche mark) deal for Ex-Cell-O, a machine tool manufacturer and a former subsidiary of U.S.-based Textron Inc. — what was then the largest management buy-out of a West German company.

In the past few weeks, Ex-Cell-O became the first company to be listed on the Frankfurt and Stuttgart exchanges after a man-

gest new issue in West Germany this year, with nearly $56 million of shares placed with investors.

"We succeeded in paying back 75% of the acquisition debt in two years, so the profit was very high," said Dirk Brandis, a portfolio manager of Schroder's German fund, which recently invested in such diverse companies as Rohe GmbH, which produces car wash systems, and Heingericke GmbH, a motorcycle accessories retailer.

But deals like Ex-Cell-O and the proposed $3 billion Gateway Corp. buy-out don't signal the start of a U.S.-style leveraged buy-out boom, according to Nick Ferguson, chairman of Schroder Ventures. European leveraged buy-out activity and the market for mezzanine debt still are in their infancy, especially in West Germany and Italy.

"Banks are far more aggressive

ancing than mezzanine lenders and doing more of the debt, especially on smaller deals," he said.

In 1988, international buy-out funds run by such players as Baring International Investment Ltd. and Charterhouse Bank, both in London, and Matuschka Moser Partners, Greenwich, Conn., raised more than $3 billion (*Pensions & Investment Age*, May 29).

The newness of European leveraged buy-out markets raises the potential for high returns, according to many institutional investors.

"LBO opportunities overseas are better than they are here currently," said Dan Kelly, deputy director and general counsel of the PRIM, which is increasing foreign private investments as it boosts international stock and bond investments. In March, the fund committed $20 million to a U.K. leveraged buy-out fund of

MONEY MOVERS

HealthTrust Inc.

NASHVILLE, Tenn. — HealthTrust Inc. has hired three fixed-income and three equity managers for its $120 million pension fund, said Glenn Davis, assistant treasurer.

The money comes from a distribution of pension assets from Hospital Corp. of America. Nashville HealthTrust bought 104 HCA hospitals last year, sold 10 and kept 94.

To manage $26 million each in fixed income, it hired Sovran Capital Management, Richmond, Va.; Wells Fargo Bank's asset management division, San Francisco; and Dana Investment Advisors, Milwaukee. All are active managers and have a bias toward adding value through credit research and sector selection, rather than interest rate anticipation, Mr. Davis said. He noted the Wells Fargo division is separate and distinct from its index fund management affiliate, Wells Fargo Investment Advisors.

To handle $11 million each in equities, it hired Fisher Investments Inc., Woodside, Calif.; GAMCO Investors Inc., New York; and Sun Bank Capital Management, Orlando, Fla. All are active and value-oriented, Mr. Davis said.

Performance Analytics Inc., Chicago, assisted in the search, he said.

Bundy Corp.

WARREN, Mich. — The $64 million Bundy Corp. pension fund hired two managers and increased the allocation to another, said Rodney Morris, internal audit manager.

The fund hired Jennison Associates Capital Corp., New York, to manage $27 million, and Dillon, Read Capital Inc., New York, to run $20 million, both in balanced accounts, Mr. Morris said.

It also increased the allocation to equity manager GAMCO Investors Inc., New York, to $17 million from $8.5 million.

Mr. Morris declined to identify managers terminated by the fund. The 1989 Money Market Directory lists National Investment Services of America Inc., Milwaukee, and Weiss, Peck & Greer, New York, along with GAMCO, as managers for the fund.

Wyatt Asset Services, Chicago, assisted in the search.

Illinois State Board

CHICAGO — The $3 billion Illinois State Board of Investment has selected five managers to manage $250 million in international/global investments.

Hired to manage $50 million each in global equity mandates were Cursitor-Eaton Asset Management, London; First Chicago Investment Advisors, Chicago; and Globe Finlay Inc., New York, according to Gregory Nagle, executive director.

Hired to manage $50 million each in international equity accounts were Acadian Asset Management Inc., Boston, and Hill Samuel Investment Advisers Ltd., London.

Mr. Nagel said when the new accounts are fully invested, expected by year end, the board will approximate its 10% international/global target.

Mr. Nagel said the allocations will be funded through a 60% reduction in funds earmarked for internally managed domestic equities, which will leave that portfolio around $180 million.

University of Missouri

COLUMBIA, Mo. — The $630 million University of Missouri pension fund hired three equity managers and dismissed two, moving about $126 million, said Donald S. Holm, treasurer.

Dividing the $126 million equally will be new managers Eagle Asset Management, St. Petersburg, Fla.; Sun Bank Capital Management, Orlando, Fla.; and GAMCO Investors Inc., New York.

The fund dismissed The Putnam Cos. Inc., Boston, which had managed about $97 million, and Brignoli, Curley & Roberts Associates, New York, which had run about $29 million.

Putnam was terminated because the fund had become somewhat overweighted in large-cap and growth stocks, Mr. Holm said. It continues to use Alliance Capital Management L.P., New York, to manage $47 million in a large-cap growth style, he said. Brignoli, Curley & Roberts was dismissed because its performance was disappointing, he said.

Wellesley Group Inc., Waltham, Mass., assisted in the move, Mr. Holm said.

Results fuel

Continued from page 37

currently has about 36% of its international assets invested in Japan. That's below SBC's year-end 1988 level of about 50%, but slightly above the year's low so far of 33%. Just before the recent parliamentary elections, "we started building up our Japanese holdings again," said Mr. Ackermann. He noted SBC's exposure to Japan could dip even further by the end of the year.

Some other money managers fail to be inspired by the Tokyo market's current rise.

Nicholas D.P. Carn, investment director of CIGNA International Investment Advisors Ltd., London, said his firm has no exposure to the Japanese market, but politics isn't the compelling reason.

CIGNA began trimming its Japanese exposure as early as May 1987 on the perception that "the virtuous circle" underpinning the Japan market — of high money growth, rising exchange rates and falling commodity prices — was becoming middle-aged, said Mr. Carn. "Rather than have it die of old age, we thought we'd disinvest," he added. By last summer, CIGNA had sold all its Japanese stocks.

Mr. Carn sees little reason to re-enter the Tokyo market and politics do come into play here.

In Mr. Carn's view, the changing political and economic climate, along with increasing competition in the country's financial services industry, could lessen consensus practices related to the Tokyo market.

Colin Bradbury, fund manager for Far East portfolios at Kleinwort Benson International Investment Ltd., London, believes fundamentals make a more pressing case than politics for playing Tokyo cautiously. This year, his firm has lowered its Japan exposure for its world-minus-the U.S. portfolios to about 30% from about 45% at the beginning of the year.

Early in the year — even before Japan's political scandals exploded — his firm noticed the yen seemed to have bottomed out against the dollar. In addition, rising inflation — Japan's consumer price index is running at 2.9% on an annualized basis compared with only 0.7% in 1988 — and rising interest rates have spilled over to the stock market.

Despite a recent rally in the Japanese bond market, he foresees a "further small rise in inflation" — meaning "interest rates will still be under pressure, which is not favorable for that stock market." For the rest of this year, "I don't anticipate more than another 5% rise" in the Nikkei index, he said.

But some analysts and investors — although aware of the current political clouds in Japan — also see opportunity now in the Tokyo market.

In June, following technical sell recommendations for Japan, PCM International, Newark, N.J., reduced exposures in that market to as low as the low 20% range for its most aggressive accounts, from between 35% to 40%. It's now in the mid-20% range and "might drift higher as we cherry-pick among attractive companies," said Cassandra A. Hardman, director and senior portfolio manager at PCM.

She and others believe the results of Japan's recent elections help illuminate which stocks to pick. Taking a cue from the victory in the upper house of the Socialist Party, which supports such issues as dropping the new 3% sales tax, some observers believe consumer issues and consumer-type stocks will be gaining favor.

Ms. Hardman, for instance, cited both the retail and housing sectors in Japan as those with "cheap, interesting stocks." In the retail sector, specific stocks she likes include **Takashimaya** and **Joshin Denki**; and in the housing sector, she cited **Sanwa Shutter** and **Sekisui Chemical**.

Not surprisingly, Japanese firms were bullish on the Japanese market. In late June, Nicholas Reitenbach, senior vice president and global portfolio strategist at Yamaichi International (America) Inc., New York, forecasted another 10% rise in the Nikkei 225 by the end of the year.

"We feel the Japanese market is in a clear uptrend, and that one runs a risk by not having adequate representation in Japan," he said. He is recommending a 50% to 60% weighting for international portfolios and 35% to 40% for global stock portfolios.

Mr. Reitenbach recognizes that many money managers' Japanese weightings aren't that high. For example, he cited Frank Russell Co. research showing that, as of March 31, the median Japan weighting of 98 international managers was 39.9%, and the average was 38.1%, compared with the EAFE weighting of 63.7% then.

Seiki Hishikawa, senior vice president for Japanese equity sales at Nikko Securities Co. International Inc., New York, predicts continued strength in the Japanese market at least through August.

Beyond that, the market's performance will depend on when investors start "to focus on the next election," he said. Once elections again take center stage, "the market could become a little mixed." But between the end of July and yearend, the Nikkei index should rise another 10%, he predicted.

Given the recent victory by the Socialist Party, "we changed our stance to some extent to overweight social stocks" in Japan, said Mr. Hishikawa. Some recommended issues: in the insurance category, **Tokio Marine & Fire** and **Koa Fire & Marine**; in housing, **National House** and **Misawa Homes**; and in pharmaceuticals, **Takeda** and **Taisho**. ■

Global LBOs

Continued from page 37

Alan Patricof Associates, New York, and $10 million to Schroder's $266 million Buy-Out Fund II.

Europe has not seen the corporate governance action that has prompted many U.S. states to limit the ability to take over companies, Mr. Kelly said. Plus, European buy-out activity should get a boost from upcoming post-1992 lifting of trade barriers, he said.

"We'd be very happy with returns in the 25% range" compound annualized, Mr. Kelly said.

G.T. Venture Management, which acts as a manager of managers on behalf of such clients as the U.K. pension fund of IBM Corp., invests in Schroder buy-out funds in West Germany, Italy and the United Kingdom, as well as in its international venture capital funds. Schroder's country funds allow G.T. to retain responsibility for the country allocation decision.

G.T. officials, who run $200 million worldwide, admire the expertise of Jon Moulton, managing partner of Schroder Venture Advisers in the United Kingdom and formerly general manager of Citicorp's venture capital operation in London. G.T. also likes that Schroder provides incentives to its portfolio managers by allowing them an equity stake in deals. "There's confidence that the people who put the deals together will remain to see them through," said Rhoddy Swire, managing director.

Schroder professionals also have operations backgrounds, so they can add value to businesses rather than break them apart through asset sell-offs, he said.

Schroder has 230 investors; 50 of them contributed 80% of the firm's capital. One-third are U.S. pension funds and insurance companies including the Equitable Life Assurance Society of the U.S., New York, and The Travelers Corp., Hartford, Conn. The rest are mainly European institutions, such as Postel Investment Management, the London-based manager of the British Post Office pension fund.

Because leveraged buy-out activity is growing in Europe at varying rates, the firm's country-by-country fund format makes business sense. The format also appeals to some British pension funds that choose to invest domestically.

Schroder has specialists based in each country to understand market nuances such as exit strategies. In the United Kingdom, the dominant seller of a company is another company. But on the Continent, the dominant sellers are families, making transactions emotional decisions. In France and the United Kingdom, which have large stock markets, sales of companies can be made publicly. But in Italy, which has a small stock market, most company sales are private.

Laws of acquisition and dealmaking, tax regulations on the purchase of a company and the mix of lenders also differ by country. The United Kingdom has a global mix of lenders while West Germany has mostly local lenders; French lenders are mainly French banks.

But the financing of deals differs little among countries. Deals are typically less leveraged than U.S. transactions because Schroder deals are midsize — between $100 million and $150 million — which limits the scope for asset sales to finance mezzanine debt. The degree of leverage that could be assumed in a West German deal is higher than in the United Kingdom, where interest rates are twice as high.

Hostile bids are rare in Europe, largely because of the structure of markets. For instance, Italy has only 600 quoted companies with 90% of shares held by controlling shareholders.

Even in the larger U.K. market, pension fund managers don't immediately sell to arbitrageurs; they're quite loyal to management, deterring hostile bids, Mr. Ferguson said. ■

Using whole world gives firms upper hand

NEW YORK — Preliminary figures from the World Markets Co. PLC indicate managers were better off investing in global mandates than non-U.S. international portfolios in the second quarter.

According to the figures, the median portfolio of managers investing in non-U.S. international equities returned −0.6% for the second quarter, compared with a

Although the non-U.S. international portfolio performance was negative for the second quarter, it compared favorably with the well-known international benchmarks, the Morgan Stanley Capital International Europe Australia Far East Index and the FT-Actuaries Euro-Pacific Index. EAFE returned returned −6.12% for the quarter, while the FT-A index re-

vestments' Performance Evaluation Report.

The preliminary figures were drawn from about half of the 114 eligible non-U.S. portfolios and 14 of 24 global portfolios queried by World Markets.

The median of global portfolios compared favorably with the MSCI World and the FT-A World indexes, which returned −1.26%

"Strong demand for dollar assets, particularly from cash-laden Japanese institutions, helped send the dollar soaring despite vigorous attempts to hold it down by the world's central banks," according to the World Markets' Flash Report.

It was the second consecutive quarter in which the median portfolio outperformed the interna-

portfolio returned 2.1%, while EAFE returned −5.8% and the FT-A Euro-Pacific Index returned −6.07%.

"As in the last quarter, returns from Japan were below the overall EAFE results and portfolios benefited considerably from their low relative exposure to this market," the report said. It added that as managers' exposure to Japan

Wall St. firms' earnings slip

By Marlene Givant Star

Large investment banks ended the first half of 1989 with slight declines in earnings, but a drop in short-term interest rates and long-term Treasury rates could boost financing volume.

Earnings for the first six months of the year declined from the year-earlier period for all the large houses except PaineWebber Inc., but second-quarter earnings were "pretty good for all the firms," with most gains coming from bond trading profits, said John Keefe, vice president of Drexel Burnham Lambert Inc.

Underwriting activity has been fairly slow, particularly in equities, since the stock market crash of 1987. But lower long-term rates could reinvigorate financing activity -- and investment banking business -- as the year progresses, Mr. Keefe said. Long-term Treasury rates recently fell below 8% for the first time in years.

For the six months ended June 30, Salomon Brothers Inc.'s net income was $225 million, or $1.54 a share, modestly below the $253 million or $1.68 per share level of the first half of 1988. But Salomon's earnings surged to a record $253 million in the second quarter, or $1.89 per share, largely because of gains in bond trading -- the same discipline that depressed the firm's first-quarter results.

PaineWebber's first-half earnings improved to $24.266 million or 44 cents a share in the first half vs. $20.920 million or 27 cents a share in 1988's first six months. Expansion of the retail customer asset base accounted for the increase.

Merrill Lynch & Co., which has maintained its top underwriting market share, also was helped by the slight rise in retail activity in the second quarter, though its first-half earnings declined to $107.4 million from $121.7 million for the first half of 1988.

Morgan Stanley & Co. Inc.'s first-half earnings slipped 17% to $193.3 million from $233.9 million, while Shearson Lehman Hutton Inc.'s first-half net income fell 65% to $40 million from $113 million a year earlier, reflecting the $35.2 million pre-tax write-down of MCorp Securities in the first quarter.

Bear Stearns & Co., which ended its fourth quarter and fiscal year June 30, reported net income for the quarter of $47.6 million or 50 cents per share, an increase of 129% from fourth-quarter fiscal 1988 results of $20.8 million or 19 cents a share. Net income for the fiscal year ended June 30 was $172.4 million or $1.78 per share vs. $100.7 million or 96 cents per share. Per share amounts reflect a 5% stock dividend that will be distributed Aug. 31.

PaineWebber, the only other firm to post a gain for the first half, saw a decline in its investment banking revenue on a year-on-year basis because of fewer and smaller closed-end fund offerings, but commission revenue jumped almost 17% to $174 million in the second quarter from $149 million in the first.

Insurance commissions were the strongest contributors. While variable costs rose in the quarter, semi-fixed and fixed costs fell roughly 5% or $11.5 million from 1988's second quarter.

"PaineWebber appears to be effectively cutting and controlling costs which is needed if margins and ROE objectives are to be met," said a report by Dean Eberling, an analyst at Shearson Lehman Hutton, New York, who is recommending the firm's stock for accounts with investment horizons of one to two years.

PaineWebber has programs in place to repurchase up to 3 million shares of its outstanding $1.375 convertible exchangeable preferred stock and up to 5 million shares of its outstanding common stock, depending on market conditions. The firm previously repurchased more than 2 million shares of the convertibles and almost 3.7 million shares of its common stock.

For the six months ended June 30, Salomon Brothers, the second quarter's earnings leader, posted strong gains in its securities business. The area contributed $295 million to consolidated pre-tax earnings of $381 million and "second-quarter results reflect not only the industrywide improvement in volume in U.S. bond and equity markets, but profits across virtually all the firm's product lines," according to Salomon's quarterly earnings statement.

For Morgan Stanley, a 29.3% increase in trading, largely for its own account, and reduced compensation and benefits as a percentage of revenue from operations improved profits year to year. But the firm's second-quarter gains from re-leveraging Essex Group Inc. and the Silgan Corp., two merchant banking investments, were 2.5 times less than the firm's 1988 gain from the sale of Cain Chemical Inc., according to a report by Charlie Rose and Michael Bunyaner, analysts at Oppenheimer & Co. Inc., New York. They believe the firm's stock "will not have investment appeal until the core brokerage business cycle turns."

Merrill maintained its newly earned capital markets status and expanded its consumer revenue in the first half. The underwriting market share for all domestic issues rose to 17.7% during the first half compared with 15% in the prior year period, and Merrill increased its market share of worldwide offerings to 10.2% from 9.4% in the same period, remaining No. 1 in both categories, according to IDD Information Services Inc., New York.

Merrill's consumer markets sector posted solid revenue increases in commissions, insurance, asset management and custodial services, according to the firm's second-quarter earnings statement.

"Overall, second-quarter results pivoted on much better than expected June production despite the lack of any major closed-end fund offerings. However, margins will need to improve in order for EPS and book value growth to drive the stock to much higher levels," said the report by Mr. Eberling.

Shearson Lehman Hutton's second-quarter earnings benefited from increased investor activity and further success in reducing fixed costs, according to a company earnings statement. 1988's second-quarter results included a $69 million pre-tax charge related to the E.F. Hutton acquisition.

Shearson's investment banking revenue totaled $295 million for the second quarter, down from a record $395 million in 1988's second quarter.

Shearson's revenue from commissions and from market-making and principal transactions rose sharply from 1988, up 38% and 26%, respectively, to $533 million and $363 million in the quarter ended June 30.

Shearson's investment advisory revenue hit a record $144 million in the second quarter, up from $132 million for 1988's second quarter. ■

First-half brokerage firm earnings

	Net income ($ thous.) 1989	1988	% change	Earnings per share 1989	1988
Merrill Lynch	107,400	121,700	-12	0.93	1.06
Morgan Stanley	193,300	233,900	-17	4.86	6.07
PaineWebber	24,266	20,920	16	0.44	0.27
Salomon Brothers	225,000	253,000	-11	1.54	1.68
SLH	40,000	113,000	-64.5	0.31	1.14

Source: the brokerage firms

Pension assets fund jobs

By Marcia Parker

BOSTON — The $750 million Massachusetts Bay Transportation Authority Retirement Fund has allocated $20 million to purchase taxable state industrial finance bonds that will target investments in job-producing projects in the state.

The Massachusetts Industrial Finance Agency, which is floating the bonds, is pitching them to other public pension funds as a social investing tool. Public pension funds are under pressure to invest some of their huge portfolios in economic development in their respective states.

"This agreement is a small step with large implications," said John Gallahue Jr., executive director of the pension fund. "Public pension fund managers nationwide have grappled for years for ways to direct investments into economic development in their community. This agreement may well be a model solution. It addressed the social investing pressure."

Brian Carty, MIFA's executive director, said the retirement fund's investment could be a prototype for other public pension funds. "We see this as a way to unlock other sources of pension fund capital for business development in the state," Mr. Carty said.

MIFA will use the $20 million from the MBTA fund for five to seven business expansion projects in the $2 million to $5 million range.

Each taxable bond will have a maturity of five to seven years and is expected to generate returns to investors of 200 basis points above comparable Treasury securities.

The MBTA fund will directly purchase the MIFA taxable bonds, which minimizes costs by eliminating the need for underwriters and placement agents. MIFA and the MBTA fund will analyze the credit risk of each borrower. In some cases, MIFA will secure A rated or better letters of credit for the transactions. The combination of these program components will produce for borrowers a cost of funds below conventional rates.

Previously, MIFA sold a taxable bond directly to the $2.364 billion Massachusetts Pensions Reserves Investment Management Board. ■

Venture capital

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The 1980 funds, by the end of their eighth year, had a median internal rate of return of 15%. Venture Economics projects an average annualized return of 10% to 15% for venture capital funds in the future, while some of the funds formed in this decade will be able to achieve "true venture returns" — about 20% annualized, Ms. Vincent said.

That those returns would be similar to those of funds formed in the early 1970s doesn't mean the investment environment of the coming years will be like the environment in the '70s, she said. There are more dollars and more people in venture capital now, making going for deals more competitive, she said.

She doesn't, however, agree with the argument that there is too much money chasing too few good deals. This is true in some sectors, but not overall, she said.

Doug Le Bon, vice president of Wilshire Associates, Santa Monica, Calif., said another issue involved might be that too many new venture capital management groups have been created. Ms. Vincent said she doesn't necessarily agree; some inexperienced venture capitalists have performed quite well, she said.

partners should remember that venture capital is a long-term investment and should pay attention to the quality of the venture capitalists who are managing the money.

The recent returns illustrate the cyclicality of the asset class and the need for institutional investors to be more active, said Edward T. Tokar Jr., vice president-investments at the $7 billion Allied-Signal Inc. pension fund, Morristown, N.J. The fund has about 4% of its assets in venture capital and other private-market investments.

"I haven't seen the study, but I know the dollar-weighted returns on venture capital are extremely weak," he said.

The strong returns in the early 1980s led many investors to get into venture capital, while the weaker returns now likely will cool investors' attitudes toward the asset class, he said. "The same thing will happen that's happened before," he said.

The difference between venture capital and the public markets, he added, is that once investors are in venture capital they generally can't pull out.

Sophisticated investors, Mr. Tokar said, need to decide whether the amount of time it to be more than passive investors, possibly co-investing with their partnerships and applying the knowledge gained from venture capital to other investments, he said.

Added Ronald C. Boller, director-benefit finance at Owens-Illinois Inc., Toledo, Ohio: "If you are serious about venture capital, you pick your people carefully and you're in it for the long haul." Owens-Illinois has about 2% of its $2 billion pension fund committed to venture capital.

Anthony Hoberman, senior vice president of Alliance Capital Management L.P., New York, said venture capitalists' fees are another factor deserving investors' attention. The typical 2.5% annual management fee on total committed capital, a holdover from when venture capital funds were much smaller, is no longer justified, nor is a definition of profit that doesn't require the general partners to make back their fees before taking their usual 20% share, he said.

"I can't understand why the limited partner part of this industry doesn't stand up and say, 'This is not a good deal,' " he said.

Charging a management fee only on the capital that is at work — not that which is being held for follow-on investments — and a more appropriate definition of profit are necessary steps, Mr. Hoberman said.

mining fees more closely. General partners who have been greedy haven't done well, she said.

Mr. Hoberman added he has doubts about the usefulness of interim returns, such as those in the Venture Economics report, as such returns can be distorted by cash balances. Still, he wasn't surprised by the returns and said he would like to see better numbers from the industry. ■

Coldwell

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is not confident about future asset management of Fund VI.

Tad Jones, president of Coldwell Banker Realty Advisors, said Coldwell officials are in constant communication with clients. "We try to react to their wishes based upon our assessment of the marketplace and our assessment of the properties," he said.

While Coldwell isn't preventing property sales, Mr. Jones said, the firm does have to balance the desire to return capital to investors against getting a reasonable price in troubled markets. He said he couldn't comment further because the company is in registration with the Securities and Exchange Commission on a stock offering in connection with the sale of up to 50% of Coldwell to its employees.

Dennis Miller, ARCO's manager

Fund IV is the original choice of properties. "I was always concerned (Coldwell) never looked at disposition (sale of properties) as actively as one should," he added.

"They have presented us with what we see as a good program, and we will give them some time to see if they effect it." Most of the properties in Fund IV are fully leased, and if holding onto the properties won't improve the return, the properties should be sold at a fair price and the money reinvested elsewhere, he said.

The near insurrection by pension executives comes at a bad time for Coldwell Banker Commercial Group Inc., the parent company, whose officials hope for company growth since breaking away in May as a subsidiary of Sears, Roebuck & Co. through a $300 million leveraged buy-out.

Coldwell Banker Realty Advisors is trying to attract pension investors for direct real estate in-